

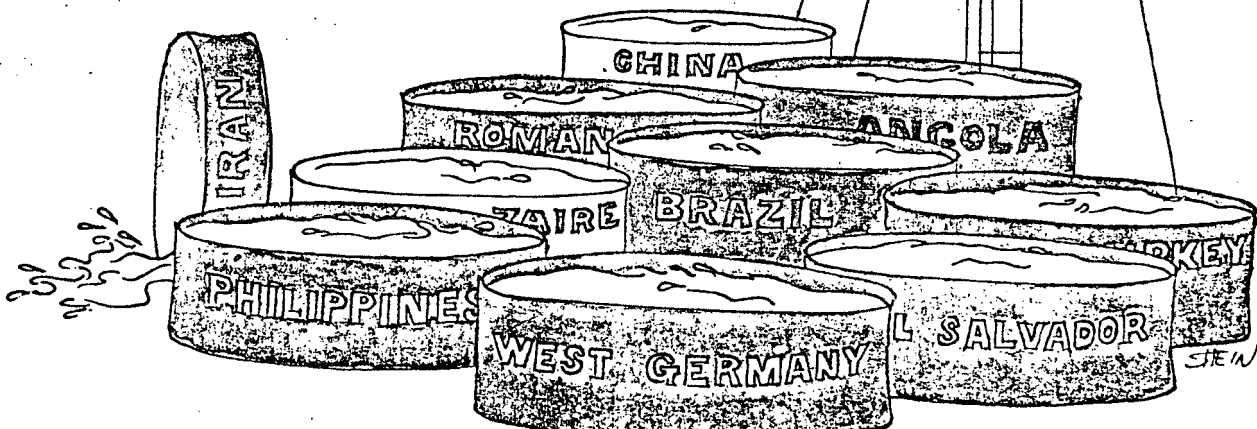
The Multinationals Get Smarter About Political Risks

by LOUIS KRAAR

Over the past decade, American corporations have been discovering one supposedly rich foreign market after another—only to have their hopes dashed or diminished by unexpected political changes or upheavals. But it remained for the revolution in Iran, which exposed U.S. companies to potential losses totaling \$1 billion, to drive home the lesson in global survival. Now even the most seasoned multinationals are looking for better means to assess—and manage—their political risks. As Stephen Blank, a political scientist with the Conference Board (the leading nonprofit research group for business), says: "Many chief executives got clobbered by winging into Iran without adequately understanding the country, and

they've gone into China the same way. Now a lot of them want to improve their grasp of the world."

Like the U.S. government, the nation's businessmen confront greater turbulence abroad and wield less power than in the past. The once-favored stratagems to shape or even topple a foreign regime—in the brash tradition of United Fruit in Central America—are no longer acceptable corporate practices. In lands where payoffs to gain leverage or win contracts are customary, Americans are bound—or at least inhibited—by the U.S. Foreign Corrupt Practices Act. As one executive remarks, "The time has passed when we could buy or rent governments."



After the Iranian bloodbath and other foreign surprises, U.S. corporations are seeking sharp professional intelligence to warn and guide them.

Instead, the top executives of major corporations are gradually acknowledging that they need both new skills and fresh insights to thrive overseas. The enjoyment of cordial personal relations with a head of state is no longer, if it ever was, a reliable way to appraise the prospects of his nation's market. Nor does the penchant of many c.e.o.'s for flying off to intriguing places, such as Islamabad or Peking, assure considered judgments back at their headquarters. Just as senior officers have long consulted their specialists on marketing and finance and law, they now sense the need for staff expertise to direct a more systematic approach to international affairs. Confronting the world these days cannot be a do-it-yourself job.

Beyond economics

This new political-risk game requires anticipating the currents of change abroad, then plotting how to move with them. To do this demands going beyond economic forecasting to gauge other forces, from religious movements to nationalistic passions. It also requires U.S. executives, who have learned the hard way, to refrain from plunging into foreign ventures merely on the strength of Washington's judgments.

The potential for corporate disaster often lurks in seemingly stable places. A few years ago Aris Gloves, a division of Consolidated Foods, wanted to spread its risks beyond the Philippines, its only manufacturing base. In 1976, the company picked a spot that its vice president, James McCorry, says "everyone, including the U.S. embassy, described as a happy, sleepy country." This carelessly promised land was El Salvador. Within some two years, political turmoil hit the Aris plant, with leftist dissidents holding its president and about 120 local employees as hostages for nine days—until the company agreed to wage increases that it couldn't afford. Six months ago, Aris fled from El Salvador.

Around the globe, the computing of future risks remains a tauntingly imprecise science—as the Philippines themselves illustrate. Thus one major manufacturer is

Research associate: Grant F. Winthrop

nervously concerned that the martial-law regime of President Ferdinand Marcos has made no visible arrangements for succession after his lifetime. On the other hand, American Can still finds the Philippines an attractive place to invest. Here as elsewhere, the right course for a company may depend heavily on its particular kind of business. In any nation, the gamut of risks runs from revolution and expropriation to the more common, but often crucial, problems of government regulation.

To avoid costly surprises, many major companies are trying a range of new safeguards. Turning to another breed of special consultants, Bechtel Corp., a loser in Iran, checks out the political climates of its Middle East markets with Richard Helms, a former director of the Central Intelligence Agency and ambassador to Iran; his one-man firm is called Safeer, the Persian word for ambassador. Varying the formula for sophisticated counsel, such major manufacturers as General Motors and Caterpillar have formed advisory councils of prominent foreign businessmen and retired government officials. Henry Kissinger serves as a paid adviser to Merck; Goldman, Sachs; and Chase Manhattan Bank, where he sits on the risk committee for foreign loans. All such moves make c.e.o.'s feel and look better—without relieving them of the ultimate responsibility for risk decisions.

A more direct damage-control device is buying political-risk insurance, a growth industry lately. The U.S. government's Overseas Private Investment Corporation (OPIC) has long insured investors in friendly underdeveloped countries against such perils as war damage and inconvertibility of earnings. A few private underwriters will fill other gaps for premiums that start at 0.1 percent for the safest places and run up to 6 percent or more for the most dangerous areas. But no policy can cover a company's entire foreign exposure.

Some corporations have therefore set up private intelligence systems. Far from using shadowy operatives with networks of secret informers, they employ political analysts who work openly. Samuel De Palma, I.T.T.'s analyst and a former assistant sec-

retary of State, says: "There's plenty of information available, but the problem is trying to find out what the hell it could portend for the company." Since executives tend to talk mostly to like-minded associates, De Palma strives to introduce them to a wider range of foreign views, "even if they're not from the sort of people we would normally invite to dinner."

The experience of Gulf Oil has made it especially sensitive to political assessments, since it was hit harder than any other oil major by the wave of nationalization that swept the producing countries in 1975. Already Gulf's four-man international-studies unit has demonstrated its perceptiveness. Richard Macken, its Middle East specialist, warned of the Shah's probable fall four months in advance and well before it was widely anticipated. Having calculated what pressures could undermine the ruler, Macken saw the Muslim demonstrations pushing Iran to a point of no return. Accordingly, the company began early its planning to cope with the subsequent loss of Iranian oil, then amounting to 10 percent of its crude supplies.

Shortly after the Soviet invasion of Afghanistan, the same analyst discounted the immediate prospect of a broader plot to seize Pakistan, where Gulf has a risky exploration venture. Jerry McAfee, Gulf's chairman, found the report "extremely useful." And McAfee adds: "Hopefully, we've helped cover the political risks by having the World Bank involved along with the Pakistan government. But we need good information on the real facts of life out there—and in the rest of the world."

Spies in the cold

To tell its top management what it *should* know, Gulf hired Hoyt Price, a former foreign-service officer, eleven years ago. He recruited the other analysts from government and universities to tap sources that few businessmen have the time or knowledge to pursue—from specialized publications to area experts. The analysts, who also visit key countries, are completely removed from Gulf's operations, to ensure their objectivity. Inescapably, though, this

To anticipate political changes that may affect its business overseas, Eaton Corp. relies on Thomas Reckford (below), its senior international analyst and a former assessment officer for the CIA. Gulf Oil gets its information and insights on the world from John Sassi, who is an Africa specialist and manager of its "international studies" team.



Leonard Schuler



Diana H. Walker

insulation often makes most analysts feel as lonely as spies out in the cold. "We're so independent," Price says, "that I sometimes wonder if we're effective."

His team's situation reports have encouraged Gulf to make deals in nations that looked forbidding at first glance. As Price says, "We try to determine whether there's a government that you can reason with." Several years ago, he recalls, Gulf President James Lee responded to a measured assessment of Zaire by remarking: "What you're really saying is that if we can get along with Mobuto [Sese Seko, the president], then go in." Today Gulf is certainly getting along with Mobuto, and its production in Zaire is being increased.

Good gamble in Angola

The company's most daring political decision has been to work with the Marxist regime in Angola, despite Washington's initial qualms. By following its own intelligence, Gulf survived the transition from Portuguese colonial rule and the ensuing civil war among three indigenous groups in 1975. The U.S. opposed—with arms and money—the Popular Movement for the Liberation of Angola, which was backed by Cuban troops and appeared to Wash-

ington as a mere tool of the Soviets. But Gulf, which had men on the scene, drew a different conclusion. John Sassi, its African analyst, correctly foresaw the emergence of a well-organized Marxist group as both the dominant force and a potentially stable business partner. He explains: "Its leaders, who were the most consistent among the Angolans in meaning what they said, indicated an interest in continuing the oil arrangements." As things turned out, Angola has become one of Gulf's largest overseas production sources.

In weighing similar hopes and hazards, Exxon goes a step further than most corporations by integrating its political assessments into financial plans. In considering a possible \$1.2-billion expansion of its copper-mining project in Chile, for instance, Exxon is comparing its vast intelligence with views from a panel of outside experts on the country. The Chile investment proposal could include what an executive gingerly calls "an environmental uncertainty factor." If Exxon detects the probability of a radical change in government or tax policy, the company may add 1 to 5 percent to its required return on investment. This risk factor is not arbitrarily tacked on, but jointly estimated by

financial planners and political analysts.

So far, Exxon has avoided rude shocks abroad by getting sophisticated appraisals through its regional divisions, the hubs of its corporate intelligence. Esso Eastern in Houston has already assigned its managers in Asia an "alert reporting list" of possible events that can affect future business. Richard Barham, the company's government-relations adviser and a fifteen-year veteran of the U.S. foreign service, says that he analyzes each Asian society in terms of its "principal influence groups." His colleagues in the field maintain regular contact with intellectuals and labor leaders as well as politicians. "We never accept their reports at face value," Barham adds, "but check them with many other sources."

Decisions in a vacuum

This political monitoring has prompted Exxon to withdraw from refining and marketing in India, Bangladesh, and the Philippines. Earlier, its analysts dissuaded the company from carrying out a commitment to build a refinery in South Vietnam at a time when other U.S. companies were still expanding operations there.

Unlike the worldly oil majors, Eaton Corp. long took its readings of foreign political climates with what an executive admits was "a seat-of-the-pants approach." Its managers, narrowly preoccupied with manufacturing truck components, marched blind into some avoidable pitfalls—such as putting a plant in France's southern Normandy region, which is notable for its troublesome Communist unions. Three and a half years ago, Eaton's chairman, E. M. de Windt, decided, as he now says, that "we can't afford to make far-reaching decisions in a vacuum." So the company hired a pair of able CIA veterans. Richard Lethander, a Ph.D. in economics, is the chief analyst at corporate headquarters in Cleveland. Thomas Reckford, the senior political analyst, based in Washington, says: "We try asking the right questions to help prevent Eaton from being startled by what happens abroad."

Its department of international information and analysis now alerts Eaton executives

continued

To anticipate political
its business
international
for the



Walter Bennett

Former CIA Director Richard Helms now counsels half a dozen corporate clients, including Bechtel. His is a one-man consulting firm which, in Helms's words, provides "realistic political assessments" of countries in the Persian Gulf area and the Far East.

utives to the implications of a swirl of events, as a few excerpts from its weekly reports indicate. Washington's freeze on technology exports to the Soviet Union: probably ineffective, but "will hurt American companies, and help Japanese and European companies." Premier Indira Gandhi's return to power: "India's at best mediocre climate for foreign investment is unlikely to improve much." Taiwan's prospects since the break in U.S. diplomatic ties: a strong economy and "political stability appears virtually assured at least through the mid-Eighties." This brisk analysis is only part of a broader intelligence process that includes comprehensive studies and briefings for the chairman and president, whom Reckford calls "our best customers."

Such a fresh array of opinions, many of them skeptical, inevitably increases tensions in most companies. As Reckford observes, Eaton's operating executives "have vested interests and are not terribly fond of people who raise red flags." Among other warnings, the analysts have emphasized the inherent risks of a proposed joint venture for making truck components in China, where the ground rules for foreign investors are still vague and evolving. Most dispassionate observers of the People's Republic also recognize that the political consensus for its modernization program is shaky. The product-minded managers can—and do—exclude the supposed bearers of bad news from some meetings on investment plans. The analysts, of course, then go straight to the top of the corporation with unsolicited assessments.

The Xerox formula

On occasion, however, the analysts act and speak as dissenting optimists. "If we've accomplished anything," Reckford says, "it's improving the way our officers think of Italy." Eaton's nine plants there are operating fairly well, but its executives had been somewhat unnerved by a political scene so often unsettled by strikes, Communist-party strength, and government by shaky coalitions. The analysts view Italy as reasonably stable, despite its political squabbles and theatrics. By put-

ting its apparent chaos into perspective, they evidently have calmed some of the fears in Cleveland headquarters. As Reckford remarks, "What's normal for Italy would cause apoplexy here."

Other companies have devised other strategies. Rather than hiring political analysts, for example, Xerox primarily relies on a well-placed group of foreigners. Two years ago, its Latin American managing directors were made formally responsible for both anticipating and planning how to deal with local political risks. Now their annual raises partly depend on their political acumen. Before introducing this system, Xerox had suffered such unwelcome surprises as sudden import restrictions that threatened its shares of some markets. Daniel Sharp, director of international relations, says: "Though we still have some serious problems, they haven't become crises lately because the issues affecting our business are dealt with much earlier." Quarterly reports from the local managers keep U.S. executives informed about foreseeable moves that may affect their business in each country. One meeting of the Latin American group last year, for example, considered issues ranging from the impact of five new regimes to the chances of Mexico lifting its tariff protection for Xerox's plant.

Xerox consults outside authorities on major issues, but Sharp says that "our best sources" are the local managers. As he explains: "They are better educated and informed about their environments than

anyone here at staff headquarters. Often they went to school with those who run the government and other important institutions in their countries." Xerox's sense of security in Latin America is also enhanced by its practice of operating through joint ventures. Its managers have access not only to government cabinet officers but also to the working-level technocrats and politicians who shape legislation. Encouraged by results in Latin America, Xerox is extending the new system to its other international operations.

The new ventures of American Can in developing countries are guided by a computer program called PRISM, i.e., "primary risk investment screening matrix." The company devised the program two and a half years ago, when its top management became dissatisfied with its limited overseas business, then confined to such obviously stable places as Britain and Canada. As James Malling, vice president for international sales and marketing, explains: "We had no operational problems caused by local politics, but wanted to find new opportunities." The problem was finding the safest ones, because the capital intensiveness of its plants, Malling adds, "heightens the risks." And by senior management's insistence, the solution had to be stated in quantitative terms.

From Kuwait to Korea

Though PRISM is no panacea, the mathematical model does help screen about seventy nations in terms of American Can's special interests. The numbers that go into the computer represent judgments gathered from many sources, including country-risk rating services (see box, page 95). But PRISM reduces some 200 variables for each country to two numbers: an index of "economic desirability" and an index of "risk payback" (a measure of political and economic stability). The company will consider investing only in the ten or twelve nations with the highest PRISM ratings. Kuwait, for example, appears economically attractive but politically questionable. South Korea's favorable computer rating prompted American Can to send an invest-

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tigation team, there and invest in a joint venture last year. Since then, of course, U.S. business confidence in the country has been shaken by the assassination of its president, a power grab from within its military establishment, and the exceptionally high inflation and the low economic-growth rate expected this year.

At United Technologies Corp., another computer program for measuring foreign risks is fed data from questionnaires filled out by its overseas managers, other businessmen, U.S. officials, and academics. Benjamin Hardy, a political scientist and staff analyst for the company, says: "Admittedly, all of this analysis is the result of a lot of subjective judgments, but it lets senior management see at a glance the results of assessment by a large number of knowledgeable people." United Technologies, which does business in 130 countries, looks far beyond its computer printouts. As Hardy says, "We would like to identify countries—possibly Zaire, Indonesia, and India—where conditions may not be attractive today, but where change may favor increased involvement in the future."

Struggle through chaos

Even after the Iranian upheaval, there remain an astonishing number of corporations without any centralized, systematic means for focusing attention on political risks. In a rather hapless reflection on the experience of Iran, an executive of G.T.&E. says, "We look back and say to ourselves: 'How could we have been so wrong?'" In December, 1977, G.T.&E. signed a contract for more than \$500 million, the largest communications-equipment deal at that time. The company had to advance Iran \$94 million in open letters of credit, which are widely used in the Middle East in lieu of various performance bonds. But G.T.&E.'s contract did not spell out the grounds on which the Iranian government could call the letters of credit, and the company did not have insurance to cover such risk.

G.T.&E. struggled mightily but vainly to carry out its job despite the political chaos in Tehran. When the Ayatollah Khomeini came to power, the company began dis-

CAN A COMPUTER TELL THE RATIO OF RISK?

To help them cope with the uncertainties of doing business abroad, many companies subscribe to services that publish country-risk indexes, somewhat like Moody's bond or Value Line stock ratings. Though there is some debate about the usefulness of numerically rating countries for risk, the client lists of the three organizations read like the FORTUNE 500.

A company considering expanding into Indonesia, for example, might well consult all three of that country's ratings. It could look at the BERI (for Business Environment Risk Index) rating, which ranks countries on a scale of 1 to 100. Indonesia scores a 45.5, a low enough rating to be marked a "high risk." A similar index put out by Business International (BI), an advisory service for multinationals, gives Indonesia a slightly more respectable 58. Finally, the World Political Risk Forecasts (WPRF) service of Frost & Sullivan, a business-research organization, expresses its own rather dim view of Indonesia in its January, 1980, forecast: a company doing business there stands a 31 percent chance of a major business loss owing to political developments in the next eighteen months and a 45 percent chance of loss within five years. A better bet for investment would be nearby Singapore—BERI score 74.9, BI rating 79, and WPRF loss probab-

ity of only 19 percent in the next five years.

Executives appreciate these rating services because they are relatively cheap (\$500 a year for BERI, \$1,500 for WPRF), and they boil down the complex forecast to simple numbers. Says Frederick Haner, the University of Delaware business professor who compiles the BERI rating, "Executives treat these numbers as though they came from God directly." In fact, they are derived from weighting and averaging the evaluations of economic, political, and social factors in foreign countries made by panels of "experts." BI's information comes from its employees around the world; WPRF and BERI don't identify their panelists beyond describing them as experts from business, government, and academia.

The most frequent criticism of this indexing is that, although it is based on largely subjective evaluations, the figures imply a mathematical precision that really isn't there. One risk analyst for a major U.S. corporation calls indexing "a substitute for thought." But the purveyors of risk ratings—and many of their clients—claim indexing is a useful tool, though obviously not the only one, for assessing risk. In any case, the troubled world of international business has made risk rating a growth industry. —GRANT F. WINTHROP

cussions that might lead to the government's honoring of unpaid bills and paring the size of G.T.&E.'s contract. Says Richard Couch, a vice president who then headed the Iran operation: "We were still negotiating—and extremely close to signing a memo of understanding—on the day that the U.S. embassy was seized." If its work is never resumed, G.T.&E. will have lost more than \$50 million, not including those worrisome letters of credit. In a few cases, other countries have called similar LC's for political reasons. The company tried to get a U.S. court order preventing its banks from honoring them if they are called, but failed.

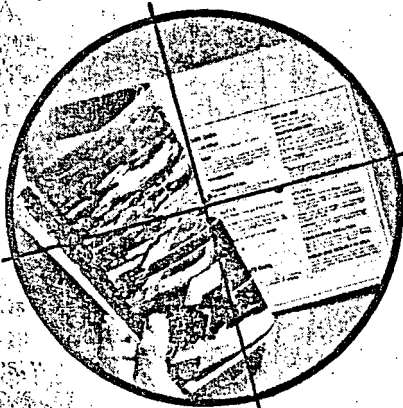
In the wake of G.T.&E.'s misadventures in Iran—according to Robert Gressons, the president of its communications products group—the company did begin to "examine our intelligence." Yet G.T.&E. still has no department or specific person respon-

sible for weighing political risks, except for project-financing officers, who rely mainly on the opinions of officials in Washington. "Given the same set of facts that we had for Iran," Gressons adds, "we'd make the same decision today. Knowing what we do now, I think we'd never accept a letter-of-credit arrangement again."

Probably no American company leaped into Iran with the zest of Starrett Housing Corp., an overseas novice that could have had a reliable safety net at home. In 1975, the company launched two big housing projects with Iranian minority investors close to the Shah. They have since left the country—leaving Starrett with a group of uncompleted luxury condominiums near Tehran and a potential corporate exposure greater than its net worth. (The company invested \$38 million in the Iranian work; its stockholders equity is only \$22.6 million.) According to an OPIC official in

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Waving a letter from an Iranian bank, the chairman insists that it covers his potential \$38-million loss.

Washington, the government agency was prepared to cover part of Starrett's risks, but the company decided not to pursue it "because of price considerations." At least three private U.S. insurance brokers say that they also were spurned by Starrett. The OPIC official adds, "A lot of people feel that they have essentially erased political risk by the associations they take on in a host country."

The chairman of Starrett, Henry Benach, relates that he took out an Iranian form of coverage. As he tells it, "In 1976, we got a letter from Bank Omran guaranteeing us protection against exactly what has happened. All of our \$38 million is covered." Waving a paper around without showing it, Benach insists that the letter states "We have to have our money back." But Bank Omran, which was closely associated with the Shah's business interests, has obviously undergone a change in management. To get its letter honored, Starrett is attempting U.S. court action.

Fresh eye on the banks

By way of contrast, not even Iran has been a calamity for Cabot Corp., which has a strategy for minimizing its risks in establishing carbon-black plants abroad. Robert Charpie, its president, says that the company recognizes "the strong tide of nationalism in the Third World." Thus Cabot finds reliable partners for joint ventures, which have local borrowing in their debt structures. "The quality of the partners you pick is your greatest insurance," he adds. But Cabot protects its own investment with OPIC insurance against expropriation and restrictions on repatriation of earnings. In Iran, Charpie says, "our original equity of \$3 million is well covered," and the company has already filed its insurance claim. Previously, Cabot collected for similar losses in Argentina and Colombia.

Many companies that sense the need for sharpening their geopolitical perceptions are not quite sure what to do. As Gerald T. West of OPIC remarks: "More sophistication is applied within some corporations to their overhead sprinkler systems. The future is to an extent knowable,

so you don't have to be fatalistic."

In the case of the American banks, they have a fresh incentive for improving their acuity. This has come with closer federal monitoring of their loans to foreign countries. The examiners want to scan the banks' methods for making political and social assessments, as well as the usual economic evaluations. In the words of Joseph Tunney, a vice president and the country-risk manager of Chemical Bank: "Iran was a watershed, making us appreciate that our kind of liberal-arts approach to political analysis had to change. Political readings can no longer be an ancillary part of our risk reports."

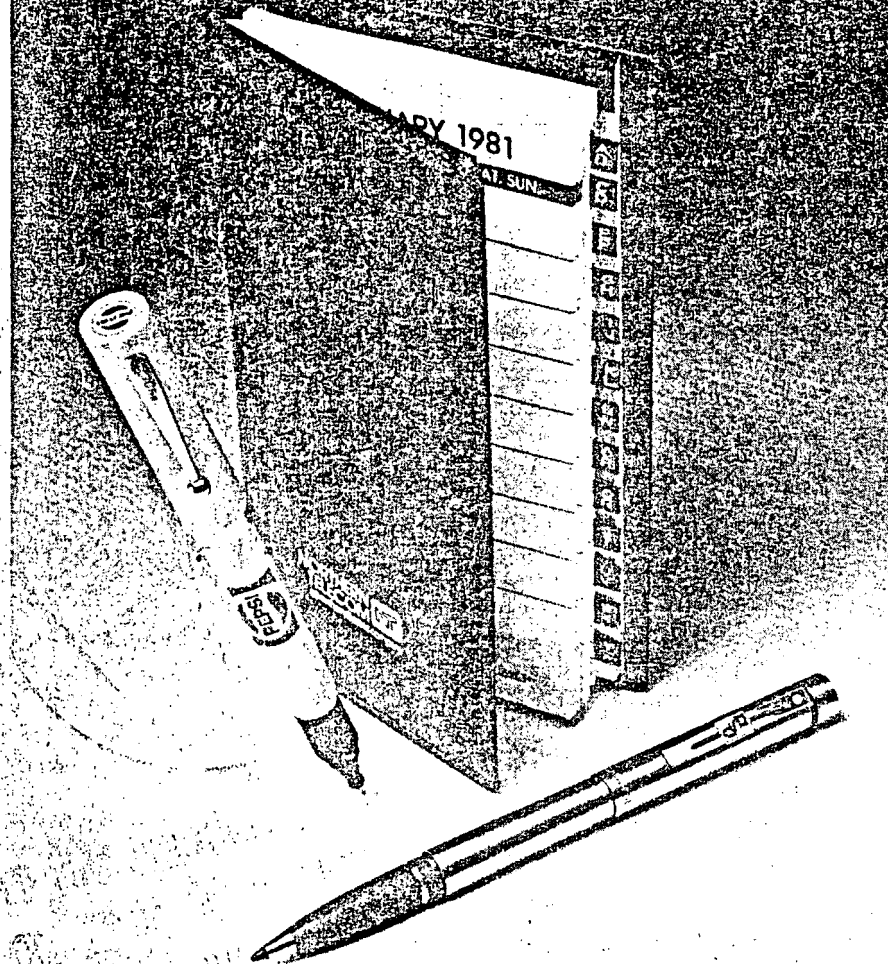
With this awareness, Tunney had adopted an approach used by Lawrence Bloom, a consultant on political risks. The bank's officers have started viewing each country in terms of its political issues and its political actors, hoping to determine which actors exert the most influence over key decisions. This assessment gives them, Tunney says, "a spread sheet for looking at politics in much the same way as they do corporate annual reports." While the method hardly can guarantee perfect judgments, it appeals to bankers as being orderly and specific. And now that federal examiners expect more formal political appraisals, Tunney expects that many bankers will have to turn to outside experts.

The new breed of international political consultants finds its clients among the companies most fearful of plunging into the unknown. Benjamin Weiner is a former foreign-service officer who started his firm, Probe International, nine years ago. "Stability per se is irrelevant," he observes today. "One-third of the world's governments change every year, often not by normal or democratic processes. The question for a corporation is whether it can identify the nascent scenarios and cope profitably—and ethically—with them." Probe sought to do just that for a dozen clients last year. One American manufacturer, for example, was interested in forming a joint venture in Egypt, but he anxiously wondered how long Sadat might be around. Taylor Crosby, an Arabic-speaker

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"A private industry of political analysis"

ing member of Probe's staff, visited the country and concluded that Sadat's economic policies would survive him. But the report raised other questions that the client had not considered—such as the hazards of teaming up with notoriously inefficient Egyptian state corporations.

Looking toward the broad future for U.S. corporate enterprise across the globe, William Colby, the former CIA director who is now a Washington attorney, says that he is encouraged by "the development of a private industry of political analysis." As he explains: "Companies are not looking for secret plans, but need to understand all the events that influence their interests. You can't develop a crystal ball because the variables that influence action are infinite. But you can increase the businessman's feel for the probabilities."

Just one choice

To improve precisely this "feel," a dozen major corporations are currently participating in a long-term effort at the Conference Board. Its international political and social analysis program not only studies key countries in depth but also examines ways for companies to analyze them more astutely. An initial survey of 193 corporations—all of them doing substantial business abroad—found that about half of them still have no formal means for making political assessments. Among them, most high-level decision-makers relied mainly on nothing more coherent or sophisticated than talking with a few people whom they trust.

Although the recent surge of interest in risk management is encouraging, the threat of corporate losses abroad is only one part of the challenge. Many openings are being missed for the wrong reasons. As one Conference Board study notes, "Certain countries are dismissed from consideration on the basis of information that is incomplete, outdated, and in some cases erroneous." Since U.S. corporations face ever fiercer competition abroad, and their own power has diminished, the leaders of these enterprises have only one choice—to get smarter about the world.